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Supreme Court of the United States

OCTOBER TERM, 1941.

No. 907.

THE CITIZENS NATIONAL BANK OF KIRKSVILLE, MISSOURI, PETITIONER,

VS.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

JAMES W. BROADDUS,
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HENRY J. PLAGENS,
Of Counsel.

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THE CITIZENS NATIONAL BANK OF KIRKSVILLE, MISSOURI, PETITIONER,

VS.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Petitioner, The Citizens National Bank of Kirksville, Missouri, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Eighth Circuit entered in the above entitled cause.

OPINION BELOW.

The opinion of the Board of Tax Appeals (R. 26-35) is reported in 42 B. T. A. 539. The opinion of the Circuit Court of Appeals (R. 46-53) is reported in 122 F. 2d 1011.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on October 16, 1941 (R. 54); a petition for rehearing was filed (R. 55-62), which was overruled on November 4, 1941 (R. 61).

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, United States Code, Title 28, Section 347.

QUESTIONS PRESENTED.

Whether the annual payment of $2,400 to Frank Baird during 1936, the year herein involved, for his life interest in the property occupied by the petitioner constitutes an allowable deduction from its income:

(1) As exhaustion or amortization of the terminable interest acquired from Frank Baird, or

(2) as annuity payments made in the acquisition of Frank Baird's interest in the property; or,

(3) in the alternative, whether the sum of $1,971.44 representing that portion of the $2,400 payment made in 1936 applicable to the payment for Frank Baird's interest in the building that was demolished in 1923 is deductible.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1936, Chapter 690, 49 Statute 1658:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for

personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a grade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * * *

(f) Losses by Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * *

(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

Article 23 (e)—2 of Treasury Department Regulations 94, (Revenue Act of 1936):

Voluntary removal of buildings.—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements is deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate,

exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

STATEMENT.

For its finding of facts the Board of Tax Appeals adopted the stipulation of facts entered into between the parties (R. 17-27), a summary of the portions thereof pertinent to the issues presented are as follows:

The petitioner is a corporation engaged in the general banking business at Kirksville, Missouri (R. 17). From 1906 to 1912 it rented the premises occupied by it from William T. Baird who died testate in the latter year (R. 17-18). Under his Will his son Frank Baird was given the income from the property during his life time with remainder to his daughter, Alta Baird Belshe (R. 22). The Will further provides that if the building is destroyed by fire or tornado Alta Baird Belshe "is to have the right to rebuild using the insurance money in such rebuilding, and to pay Frank an amount monthly equal to the amount he had been realizing net out of the rental" of the property (R. 22).

On April 21, 1920, the bank entered into a contract with Frank Baird whereby he conveyed his interest in the property to the bank in consideration of the payment to him of $200 a month during life, Frank agreeing to keep the roof in repair and giving the bank the right to make other repairs. The contract further provides that Frank Baird keep the building insured and in the event the building is destroyed by fire or storm, the rights and liabilities of the bank therein granted and created shall end, and the parties thereto shall stand in the same relation to each other as if the contract had never been made (R. 18-19).

On August 17, 1920, the bank purchased the remainder interest in the property from Alta Baird Belshe for $10,000 (R. 20).

The building was in need of repairs (R. 18) and on December 4, 1920, the bank set aside the sum of $5,000 for "improvements of building fund," and equal amounts were set aside in 1921 and 1922, making a total of $15,000 for this purpose (R. 20).

On January 10, 1923, the bank authorized repairs and alterations to be made to the building and to install new fixtures (R. 20). It was then found to be more practical because of the damaged condition of the building to demolish it and to construct a new building. This was done. A new building was constructed at a cost of $43,096.96, and the bank has since occupied the first floor of the new building (R. 20).

The bank paid Frank Baird $200 a month from 1920 to 1936, inclusive, and Baird paid insurance, under the terms of the agreement, averaging $33.84 a year, or $2.82 a month, leaving an average monthly net income of $197.18 (R. 20-21).

Frank Baird was 61 years of age April 21, 1920, and had a life expectancy based on mortality tables of 13.47 years. The value of an annuity of $197.18 a month similarly computed as of April 21, 1920, is $21,918.37. On the last date mentioned the fair market value of the land and building was $35,000, and of the land alone $6,250 (R. 21).

On its income tax return for 1936, filed on a cash receipts and disbursement basis (R. 17), the bank claimed the payment to Frank Baird of $2,400 as a deduction from income which was disallowed by the Commissioner (R. 8, 19). The bank appealed to the Board of Tax Appeals (R. 2-15), where the action of the Commissioner was sustained (R. 26-35). The Circuit Court of Appeals affirmed (R. 54).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that the payment to Frank Baird of $2,400 in 1936 did not constitute an allowable deduction

from petitioner's gross income as (1) exhaustion or amortization of the terminable interest acquired from Frank Baird, or (2) as annuity payments made in the acquisition of Frank Baird's interest in the property, or, (3) in the alternative, the sum of $1,971.44 representing that portion of the $2,400 payment applicable to the payment for Frank Baird's interest in the building that was demolished in 1923 was not allowed as a deduction from gross income in 1936.

2. In affirming the decision of the Board of Tax Appeals.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

I.

(1) In denying the petitioner the right to deduct from its gross income the annual payment of $2,400 to Frank Baird in 1936, as exhaustion or amortization of the terminable interest acquired from him, the Circuit Court erroneously construed an important federal statute in direct conflict with a decision of this Court.

(a) The Circuit Court erroneously held that the payments to Frank Baird come within and are expressly prohibited by the provisions contained in Section 23 (a) of the Revenue Act of 1936, Chapter 690, 49 Stat. 1658, which allows a deduction for "rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property," which deduction is limited to "property to which the taxpayer has not taken or is not taking title or in which he has no equity." In the proceedings below, neither the petitioner nor respondent regarded these payments as coming within the above provision as "rentals or other payments." The Circuit Court expressly held that these payments constitute a "part of the purchase price" of the life estate and therefore held that the payments come within the term "or other payments" and that the deduction was expressly prohibited since petitioner was "taking title or in which it had an equity" (R. 50-51). In *Duffy* v. *Central Railway Company*, 268 U. S. 60, l. c. 64, 69 L. Ed. 846, wherein the meaning of "or other payments," as contained in this provision, is defined as meaning "to bring in payments, *ejusdem generis* with 'rentals,' such as taxes, insurance, interest on mortgages, and the like, constituting liabilities of the lessor on ac-

count of the leased premises which the lessee has covenanted to pay."

(b) The decision of the Circuit Court is in direct conflict with the Court's definition of the term "or other payments," which interpretation removes all possible doubt that the payments herein involved do not come within this term. Since the above quoted restrictions do not relate to any of the other deductions permissible under Section 23 (a), *supra*, such as "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" etc., it is therefore immaterial as to whether or not petitioner was "taking title, or in which it has an equity" in determining its right to the deduction under the other provisions of this Section. Also, contrary to the statement contained in the Circuit Court's opinion (R. 51), petitioner at no time contended that in 1936 it had not "taken," was not "taking title," and that it had no "equity" in the property.

(c) Unless the Circuit Court's erroneous interpretation of Section 23 (a), *Supra*, is rectified by this Court it will not only deprive petitioner of a deduction authorized by law but will no doubt result in confusion and much litigation as to future interpretation of this Section.

(2) In denying the deduction as exhaustion or amortization of the terminable estate acquired from Frank Baird, the decision of the Circuit Court is in direct conflict with that of this Court and the United States Circuit Court of Appeals for the First, Second, Third, Fifth and Sixth Circuits in the following cases:

Duffy v. *Central Railroad Company*, 268 U. S. 60, l. c. 64, 69 L. Ed. 846.

Davison v. *Comm.*, 2nd Cir., 60 F. 2d 50.

Baton Coal Company v. *Comm.*, 3rd Cir., 51 F. 2d 469.

King Amusement Company v. *Commissioner of Internal Revenue*, 6th Cir., 44 F. 2d 709.

United States v. *Boston & Providence R. R. Corp.*, 1st Cir., 37 F. 2d 670.
Galatoire Bros. v. *Lines*, 5th Cir., 23 F. 2d 676.

(a) Each of the above decisions hold that payments for a leasehold estate and the capital cost thereof is returnable by annual deductions spead over the term of the estate. Since the payments herein involved are required to be made in equal annual payments during the life of Frank Baird the amount paid each year constitutes an allowable deduction in the year payments are made in accordance with the above decisions and Section 23 (a), *Supra*, or Section 23 (1) of the Revenue Act of 1936, Chapter 690, 49 Stat. 1660. In the case of *Davison* v. *Comm.*, *Supra*, wherein the taxpayer paid a single sum for a leasehold and an option to purchase which taxpayer later exercised, referring to the single sum payment for the leasehold and the option, the Court said, l. c. 52:

> "So much of it as represents the cost of acquiring the leasehold should be regarded as an exhaustible capital investment returnable by annual deductions spread over the term of the lease."

(b) The contract whereby petitioner acquired Frank Baird's life estate in the property contains the express provision that his life estate would revert to him in the event the building was destroyed by fire or storm, and petitioner would thereupon be relieved of making any further payments (R. 19). The remainder interest was owned by Alta Baird Belshe and her father's Will provided that in case of such destruction she "is to have the right to rebuild using the insurance money in such building, and to pay Frank an amount monthly equal to the amount he had been realizing net" from the property (R. 22). Subsequent to acquiring Frank Baird's life estate petitioner acquired the remainder interest, and thereby acquired the right to rebuild in the event of such destruction and to continue the payments. If, however, at

the time of such destruction the petitioner did not deem it advisable to rebuild and continue the payments to Frank Baird and elected not to do so, then Frank Baird would immediately be reinvested with his life estate. Furthermore, if petitioner did elect to rebuild in such event, under the express provisions of the Will, the property is charged with the liability to continue the payments to Frank Baird, and if the payments are not continued he would be entitled to regain full possession of the property for the remainder of his life. Therefore, Frank Baird has at all times had, and will continue to have until his death, a contingent reversionary interest in the property which constitutes an intermediate estate and prevented the interest acquired by petitioner from merging, and consequently the two estates have remained separate.

The decisions of the Missouri Courts as well as other courts uniformly hold that there cannot be a merger of estates so long as there is outstanding an intermediate estate. *Willis et al.* v. *Robinson,* 291 Mo. 650, 237 S. W. 1030 (S. Ct. Mo.); *Morgan et al.* v. *York,* 91 S. W. 2d 244 (Mo. App.), and *Hospes* v. *Almstedt,* 83 Mo. 473. The last two cases also hold that mergers are not favored in courts of law or equity, and even though there is no outstanding intermediate estate there is no merger when that is the intention; and in the absence of evidence to the contrary, the intention will be presumed to accord with the best interest of the interested party.

The payments involved herein are only for the life estate and no deduction is claimed for the cost of the remainder interest, and under the authorities cited constitutes an allowable deduction from income. The Circuit Court said that the question as to whether or not there was a merger was not material (R. 50), and held that the deduction was expressly prohibited by Section 23 (a), *Supra.* The Board of Tax Appeals did not make a determination as to whether or not there was a merger (R. 34, 35).

II.

(1) In denying petitioner the right to deduct from its gross income the $2,400 paid to Frank Baird in 1936 as annuity payments, the decision of the Circuit Court is in direct conflict with that of the United States Circuit Court of Appeals for the Second Circuit in the case of *Commissioner of Internal Revenue* v. *John C. Moore Corporation,* 42 F. 2d 186.

(a) Petitioner's agreement to pay Frank Baird $200 per month for life (less an average of $2.82 per month for insurance or a net amount of $197.18) constitutes a contract to pay an annuity; that the value of such annuity payments based on Baird's life expectancy is $21,918.37, which payments had been made by 1933 plus the sum of $10,000 paid for the remainder interest making a total consideration for the property of $31,918.37. The fair market value of the property was $35,000. The payments made to Frank Baird by January 1, 1936, amounted to $37,600, which together with the amount paid for the remainder interest of $10,000 makes the total payments made by petitioner for the property as at that date of $47,600.

(b) All payments subsequent to 1933 constitutes an expense or loss to the petitioner under the provisions of Section 23 (f) of the Revenue Act of 1936, Chapter 690, 49 Stat. 1659. In the case of *Commissioner of Internal Revenue* v. *John C. Moore Corporation, Supra,* the Court said, l. c. 188:

> "2. We find no difficulty in approving the method employed by the Board in treating the transaction as a sale of an annuity to Mrs. Moore in return for her conveyance of property agreed to be worth $80,000. It is not necessary to predicate the result on the fiction of dividing the sale of the property and the purchase of the annuity, each for $80,000, into two transactions. An annuity writer can accept property for his annuity agreement as well as cash."

The determining factors in that case are almost identical with the facts in the instant case and it is held that all payments after the life expectancy of the annuitant was reached constitutes an allowable deduction as a loss or expense.

III.

(1) In denying petitioner's alternative contention that it is entitled to deduct from its gross income the sum of $1,971.44 representing that portion of the $2,400 payment made in 1936 applicable to the payment for Frank Baird's interest in the building that was demolished in 1923, the decision of the Circuit Court is in direct conflict with that of this Court and the United States Circuit Court of Appeals for the First, Second, Third and Sixth Circuits in the following cases:

Eckert v. *Burnet*, 283 U. S. 140, 75 L. Ed. 911, 51 S. Ct. 373.

Helvering v. *Price*, 309 U. S. 409, 84 L. Ed. 836.

Jenkins et al. v. *Bitgood*, 101 F. 2d 17 (C. C. A. 2d).

Page v. *Rhode Island Hospital Trust Company*, 88 F. 2d 192 (C. C. A. 1st).

Insurance Finance Corporation v. *Commissioner*, 84 F. 2d 382 (C. C. A. 3rd).

Landers Bros. Co. v. *Commissioner*, 60 F. 2d 85 (C. C. A. 6th).

(a) On January 10, 1923, petitioner authorized repairs and alterations to be made to the building and to install new fixtures. It was then found to be more practical because of the damaged condition of the building to demolish it and construct a new one, which was done. In 1920, when Frank Baird's interest was acquired, the fair market value of the land and building was $35,000, of which $6,250 represents the land and $28,750 the building. The portion of the payments made to Frank Baird in each year that is applicable to the building is 28,750/35,000 of $2,400 or $1,971.44. The Circuit Court erroneously held

that there was no definitely ascertained base upon which to calculate the loss; that the fair market value of the property furnishes no basis for determining loss sustained by destruction of property; and that the cost cannot be ascertained until after Frank Baird's death (R. 53). It will be seen that a definitely ascertained base is established and that the fair market value of the property is only used to ascertain the portion of the payments made each year that is applicable to the building, and no other method can be used to determine this factor, even after Frank Baird's death; and that the portion of the annual payments represent petitioner's loss as a result of the building having been demolished is definitely established, and to await Frank Baird's death can have no bearing in determining the resulting loss actually sustained in each year.

(b) This deduction is claimed under the provision of Section 23 (f) of the Revenue Act of 1936, 49 Stat. 1659, and Article 23 (e)—2 of Treasury Department Regulations 94 (Revenue Act of 1936), and is based on the actual cash paid out during 1936 that is applicable to Frank Baird's interest in the building that was demolished in 1923. No one can deny that such payments represent a loss to petitioner against which there is no off-set, and for which there is no possibility of ever realizing anything under any conceivable circumstances; and since petitioner filed its return on a cash receipts and disbursements basis it can only claim a deduction for the loss as actual cash payments are made.

(c) The Circuit Court incorrectly held that the decision in the case of *Eckert* v. *Burnet, Supra,* which case involved bad debts, was not in point (R. 53). In a later decision by this Court in the case of *Helvering* v. *Price, Supra,* it is expressly held that the decision in the Eckert case applies and is controlling as to a deduction claimed for a loss upon a contract of guaranty allowable under

the provision of Section 23 (e) of the Revenue Act of 1932, 47 Stat. 180. The identical provision applicable therein is contained in Section 23 (e) of the Revenue Act of 1936, 49 Stat. 1659. Section 23 (e), *Supra*, provides for losses as to individuals. The deduction in the instant case is claimed under provisions of Section 23 (f) of the Revenue Act of 1936, *Supra*, which provides for losses as to corporations. Both Sections 23 (e) and 23 (f), *Supra*, provide that "losses sustained during the taxable year and not compensated for by insurance or otherwise" constitute allowable deductions from income.

(d) The decisions in the other cases cited above also hold that where the taxpayer is on a cash receipts and disbursements basis that deductions for losses can only be taken in the year or years when actual payments in cash or its equivalent are made, even though the loss is definitely established in a different year and the decision of the Circuit Court is in direct conflct with these decisions.

CONCLUSION.

Wherefore, it is respectfully submitted that this petition for a Writ of Certiorari should be granted.

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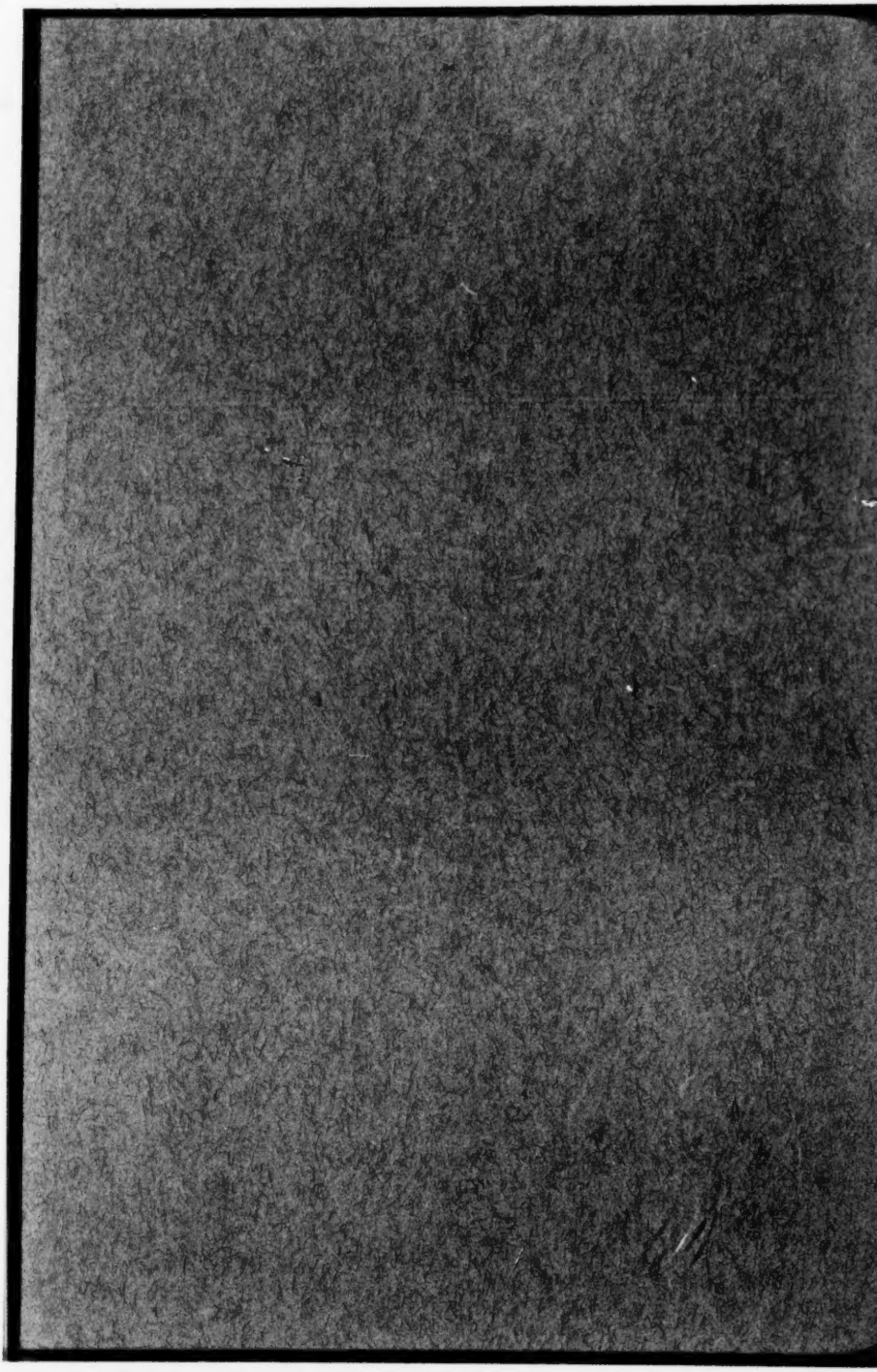
HENRY J. PLAGENS,
Of Counsel.



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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 907

THE CITIZENS NATIONAL BANK OF KIRKSVILLE, MISSOURI, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 46–53) is reported in 122 F. (2d) 1011. The opinion of the Board of Tax Appeals (R. 30–35) is reported in 42 B. T. A. 539.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered October 16, 1941 (R. 54). A petition for rehearing (R. 55–60) was denied by the court on November 4, 1941 (R. 61). The petition for a

writ of certiorari was filed on January 28, 1942. The jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Taxpayer corporation in 1920 purchased from A his life interest in real estate, undertaking to pay A $200 a month for life. Shortly thereafter taxpayer purchased the remainder from B. The questions are:

1. Whether the taxpayer may deduct from its gross income for 1936 the amounts paid to A in that year, as a business expense, in amortization of the cost of the property interest acquired from A.

2. Whether the taxpayer may deduct those amounts as a loss sustained during the taxable year, A having in 1933 outlived his 1920 life expectancy.

3. Whether the taxpayer may deduct as a loss such part of the amounts paid to A in 1936 as represents the original interest of A in a building on the land in question which was demolished by taxpayer in 1923.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

STATEMENT

A stipulation of facts entered into by the parties (R. 17–26) was adopted by the Board of Tax Appeals (R. 27–30). The facts may be summarized as follows from the stipulation:

Petitioner is a Missouri corporation engaged in a general banking business (R. 17). From the time of its organization in 1906 until the spring of 1912 the taxpayer occupied the first floor of a building owned by William T. Baird (R. 17–18, 20). Baird died in 1912, leaving a will by which he devised the

property to his son, Frank Baird, for life, with remainder in fee to the testator's daughter, Alta Baird Belshe (R. 18). The will required Frank Baird to pay the cost of repairs and insurance on the bank building (R. 22). It also provided that in the event of destruction of the building by fire or tornado Mrs. Belshe should have the right to rebuild, using the insurance money for that purpose, and would thereafter own the property outright by paying Frank Baird an amount monthly equal to the net amount he had been realizing as rental of the property (R. 18, 22).

From the death of William Baird in 1912 to April 21, 1920, the taxpayer paid rent for its occupancy to Frank Baird (R. 18). Early in 1920 petitioner found that the building which it occupied was old and greatly in need of repair (R. 18). It entered into negotiations with Frank Baird and on April 21, 1920, acquired the latter's life interest in the property (R. 18, 24). Contemporaneously with this conveyance Frank Baird and petitioner entered into an agreement which provided that Baird should paint and decorate the hallway of the building, repair the roof, keep the building insured in the amount for which it was then insured, and keep the roof in repair, during the life of the agreement (R. 19, 25). In consideration, the taxpayer agreed to pay Frank Baird $200 a month for life (R. 18, 25). The agreement further provided that if the bank building should become untenantable the obligation of the taxpayer

to make monthly payments would cease, and that if the building should be destroyed by fire or storm the rights and liabilities of the taxpayer would cease and the parties thereafter would stand in the same position as if the agreement had not been made (R. 19, 25).

Thereafter, on August 17, 1920, petitioner acquired the remainder interest of Mrs. Belshe for $10,000 (R. 20, 25–26). This amount was carried on petitioner's books as a part of the cost of the building; since petitioner acquired the interests of Frank Baird and Mrs. Belshe it has carried the land and building as a capital asset on its balance sheet. The taxpayer has reported as part of its gross income all rents received by it from the part of the bank building not occupied by petitioner. The expenses of the building, except such as were met by Frank Baird under his agreement with the taxpayer, were borne by petitioner. (R. 20.)

On December 4, 1920, the taxpayer set aside $5,000 to a fund for building improvement. Additional sums in like amount were set aside in 1921 and 1922 for the same purpose. On January 10, 1923, the taxpayer authorized the making of repairs and alterations in the bank building and the installation of new fixtures. It was subsequently discovered that, owing to the damaged condition of the foundation of the building and of one wall, it was more practical to raze the building. A new structure was then erected at a cost to petitioner of $43,096.96. The taxpayer has occupied the

first floor of the new building since its completion. (R. 20.)

Petitioner paid Frank Baird $200 a month in accordance with their agreement of April 21, 1920, from May of that year to and including the month of December 1936 (R. 20). During the same period Frank Baird paid on an average $33.84 per annum for insurance on the building, as required by the agreement of 1920 (R. 20–21).

It was further stipulated by the parties, subject to objection by the Commissioner on the ground of irrelevance, that on April 21, 1920, Frank Baird was 61 years of age and had a life expectancy on that date, based on American experience tables of mortality, of 13.47 years; that the value of the annuity contracted to be paid him was $21,918.37, computed as of April 21, 1920;[1] that the fair market value of the land and building in question on April 21, 1920, was $35,000, and that the fair market value of the land alone was $6,250 (R. 21). Taxpayer deducted on its 1936 income-tax return the sum of $2,400 which it had paid to Frank Baird (R. 19). This deduction was disallowed by the Commissioner of Internal Revenue, and a deficiency was accordingly determined (R. 6–9, 19). The Commissioner's determination was sustained by the Board of Tax Appeals (R. 26–35); and the decision of the Board was affirmed by the Cir-

[1] This calculation was based on the payment of $200 per month less a deduction of $2.82 for the insurance payments which Frank Baird was required to make.

cuit Court of Appeals for the Eighth Circuit (R. 46–53).

ARGUMENT

The Commissioner of Internal Revenue, the Board of Tax Appeals, and the court below all treated the transaction of April 21, 1920, between petitioner and Frank Baird as a step in the purchase by petitioner of the bank building and land; they considered petitioner's outlay of consideration a capital expenditure to acquire a capital asset. Stipulation for payment of the purchase price in instalments does not alter the nature of the transaction. Gain or loss would only be recognized on a final disposition of the property acquired, under sections 111–113 of the Revenue Act of 1936; the transaction would not have income-tax consequences until both sale price and cost were ascertained, and then would be regarded as resulting only in capital gain or loss, if any. This view and the corresponding disposition of petitioner's case below is clearly correct, and calls for no reexamination by this Court.

1. Petitioner claims the right to deduct payments to Frank Baird in 1936 under section 23 (a) of the Revenue Act, on the theory of amortizing the cost of the acquisition of Baird's property interest. The circuit court of appeals cases cited by petitioner (Pet. 8–9) in support of the application of such a theory to the present case are not in point, and therefore present no conflict;

in each the taxpayer was holder of a *leasehold* estate, with the cost of the term being in consequence returnable by annual deductions from gross income. Here petitioner's payments were made toward the acquisition of a fee simple in possession, so that the *rationale* for amortization is absent. It is not material for purposes of income-tax law whether or not there was a technical merger of estates in the taxpayer after it acquired the remainder interest in the property from Mrs. Belshe in August 1920.

No conflict exists, as alleged (Pet. 8), with *Duffy* v. *Central R. R.*, 268 U. S. 55. The Court there held that expenditures by a corporate lessee for additions to the leased property (required by the lease to be made) were not deductible as a business expense, stating in addition only that annual deductions for depreciation and exhaustion of the capital improvements made could be taken from year to year. 268 U. S. at 64. Obviously, the taxpayer in the present case has not calculated its claim for deduction in terms of depreciation in 1936 on the bank building erected by it in 1923. Cf. section 23 (l) of the Revenue Act of 1936.

Petitioner attacks (Pet. 7–8) the holding of the court below (R. 50–51) that the provisions of section 23 (a) dealing with rentals and similar payments by implication exclude the possibility of the deduction claimed; petitioner asserts that the provisions of the earlier portion of the subsection do not contain the restrictions as to title particular

to rents, and that its claim should be allowed as a deduction under those latter provisions. This contention of the taxpayer is contradicted fundamentally by the basis of petitioner's claim, which rests for its theory on the circuit court of appeals cases cited at pages 8 and 9 of the petition for certiorari and referred to above at page 7. Cf. Art. 23 (a)–10, Treasury Regulations 94 (1936). From the terms of section 23 (a) it is clear that the payments to Frank Baird in 1936 were not deductible as rent or similar payments, and, impliedly, not at all. Even if, as petitioner contends, it is not *thereby* barred from taking a deduction pursuant to the initial provision of section 23 (a), its claim must fail because the payments to Baird constituted not a business expense but a capital expenditure. Cf. *Duffy* v. *Central R. R.*, 268 U. S. 55.

2. The taxpayer additionally contends that it should be permitted to deduct the $2,400 paid to Frank Baird in 1936 as a loss sustained during the taxable year, under section 23 (f) of the Revenue Act, since Baird had in 1933 outlived his life expectancy, calculated as of April 21, 1920. This position is untenable in view of the *capital* nature of the transaction between petitioner and Baird; petitioner was not engaged in the commercial writing of annuities in 1920 but simply purchased an interest in property on a plan of deferred payments. Any loss that might result from an unexpectedly large total of purchase payments would

only be deductible as a capital loss on sale of the property, if the sale price were exceeded by the discounted cost. See *Steinbach Kresge Co.* v. *Sturgess,* 33 F. Supp. 897, 898–899 (D. N. J.).

Petitioner's claim (Pet. 11–12) that the decision below conflicts with *Commissioner* v. *John C. Moore Corp.,* 42 F. (2d) 186 (C. C. A. 2d), is insubstantial. The taxpayer there had purchased property from A in return for payments to A of $10,000 a year for life, and the court held that the corporation taxpayer could deduct *as interest paid* the difference on each annual instalment between $10,000 and the discounted value of the instalment at the time of the purchase. While the opinion contains statements *obiter* that are inconsistent with the decision of the court below in this case, we think the *dicta* are plainly unsound regardless of the status of the decision in the *Moore* case. See *Steinbach Kresge Co.* v. *Sturgess, supra.*

3. Finally, petitioner urges that if it is not entitled to deduct the full amount paid to Frank Baird in 1936 it should be permitted to deduct as a loss in 1936 that portion ($1,971.44) of the $2,400 which represents the original interest of Baird in the building that was razed in 1923 by taxpayer. Petitioner relies for authority on *Eckert* v. *Burnet,* 283 U. S. 140, and *Helvering* v. *Price,* 309 U. S. 409, and asserts a conflict with decisions in four circuit courts of appeals. The rule of the *Eckert* case, that a taxpayer who gives

his note in exchange for an obligation known to be worthless sustains no loss until he pays the note, is obviously inapplicable to the situation in the present case; decision in the other cases cited by petitioner stemmed from *Eckert* v. *Burnet, supra,* with the result that they are no more apposite here. It seems clear that if any loss was sustained by the taxpayer from demolition of the old bank building it occurred in 1923 and was deductible in that year only. *Union Bed & Spring Co.* v. *Commissioner,* 39 F. (2d) 383 (C. C. A. 7th); *Louis Pizitz Dry Goods Co.,* 22 B. T. A. 161.

CONCLUSION

The decision of the Circuit Court of Appeals is correct and presents no conflict of decisions. It is therefore respectfully submitted that the petition should be denied.

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No. 907.

OCTOBER TERM, 1941.

THE CITIZENS NATIONAL BANK OF KIRKSVILLE, MISSOURI, PETITIONER,

VS.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONER'S REPLY BRIEF TO RESPONDENT'S BRIEF IN OPPOSITION.

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PETITIONER'S REPLY BRIEF TO RESPONDENT'S BRIEF IN OPPOSITION.

Petitioner submits herewith its reply brief to respondent's brief in opposition.

I.

The amounts paid to Frank Baird are deductible as exhaustion or amortization of the terminable interest in the property acquired from him by petitioner.

1. It is believed that an unwarranted conclusion is contained in respondent's summary of the facts as stipu-

lated (Br. 4) wherein it is stated that the Will provided "that in the event of the destruction of the building by fire or tornado Mrs. Belshe should have the right to rebuild, using the insurance money for that purpose, and would thereafter own the property *outright* by paying Frank Baird an amount monthly equal to the net amount he had been realizing as rental of the property" (Italics ours). The Will is included as a part of the stipulation of facts (R. 21-24) which provides in substance the same as the above quoted provision except there is no statement in the Will that the property would thereafter be owned "outright" or otherwise (R. 22). In the body of the stipulation of facts (R. 18) there is contained a statement in substance the same as the above quoted provision, except it states that Mrs. Belshe would thereafter "own the property" by making the above described payments to Frank Baird. Attention is called to this provision, since it is petitioner's contention that Frank Baird has at all times had an interest in the property. The contract whereby petitioner acquired Frank Baird's life interest contains the express provision that his life estate would revert to him in the event the building was destroyed by fire or storm (R. 19). The remainder interest of Mrs. Belshe, which was subsequently acquired by petitioner, including the right to rebuild in the event of such destruction of the property, is expressly charged with the liability for making these payments during the remainder of Frank Baird's life and obviously he would have the right to regain his life interest in the property from the remainderman in the event such payments were not continued; and the remainderman (Petitioner) would in effect be nothing more than a tenant during the remainder of Frank Baird's life, or as long as the payments were continued.

2. The deduction for the payments made to Frank Baird in 1936 as exhaustion or amortization of the cost of his life interest in the property acquired by petitioner

is claimed under the provisions of Section 23 (a) or Section 23 (1) of the Revenue Act of 1936, c. 690, 49 Stat. 1658, 1660, (Pet. 9), and not under Section 23 (a) alone as stated in respondent's brief (Br. 7). Petitioner has never contended that the mere fact the purchase price was being paid in installments altered the nature of the transaction. Even though the payments for a terminable estate constitute capital expenditures they are, nevertheless, deductible from income spread over the life of the estate under the authorities cited by petitioner (Pet. 8-9).

Respondent contends that the circuit court of appeals cases relied on by petitioner (Pet. 8-9) are not in point and states that in each of these cases the taxpayer was the holder of a leasehold estate, while in the instant case petitioner's payments were made toward the acquisition of a fee simple in possession (Br. 7-8). Respondent apparently concedes that otherwise these decisions would be squarely in point, since it is stated that in each of these cases the cost of the leasehold estate was returnable by annual deductions from gross income. As pointed out in the petition for certiorari (Pet. 9) the case of *Davison* v. *Comm.*, 2nd Cir., 60 F. 2d 50, involved a single sum paid for a leasehold and an option to purchase, which the taxpayer exercised, and the portion of the payment that represented the cost of acquiring the leasehold was held to be an exhaustible capital investment, returnable by annual deductions spread over the term of the lease. Even though petitioner subsequently acquired the remainder interest, the payments herein involved were made for only Frank Baird's life estate, which of necessity remained a separate estate, and the decision of the Circuit Court is in direct conflict with these decisions, each of which permitted the identical deduction herein claimed, namely, exhaustion or amortization of the cost of a terminable estate over the life of the estate.

Respondent attempts to show (Br. 8) that there is no conflict with the decision of this Court in the case

of *Duffy* v. *Central R. R. Co.*, 268 U. S. 55, with respect to the claim for a deduction as exhaustion or amortization as contended by petitioner (Pet. 8), but the decision clearly shows that the portion of the cost of the leasehold estate therein involved, consisting of improvements having a life beyond the term of the lease, was allowed as a deduction by annual allowances for exhaustion and supports petitioner's claim to the deduction herein involved.

The Circuit Court held that the payments to Frank Baird come within and are expressly prohibited by Section 23 (a), *Supra* (R. 50-51). The decision of the Circuit Court is, without question, in direct conflict with this Court's definition of the term "or other payments" contained in the last provision of Section 23 (a), *Supra*, in the case of *Duffy* v. *Central R. R. Company, Supra*, as is pointed out in the petition for certiorari (Pet. 7, 8), and respondent does not specifically question petitioner's contention in this respect. It will be noted that petitioner contends there is a conflict with this decision in two respects as referred to in this and the preceding paragraph.

Respondent alleges (Br. 8-9) that petitioner's contentions are contradictory since it contends (Pet. 8) that the provisions contained in the earlier portions of Section 23 (a), *Supra*, do not contain any restrictions as to the deduction claimed and also relies upon the circuit court of appeals cases cited (Pet. 8-9). Respondent's assertion in this respect is not understood and it is submitted that there is obviously no contradiction as to petitioner's contentions. Respondent lastly contends, as to this point (Br. 9), that petitioner's claim must fail because the payments to Baird constitute a capital expenditure and not a business expense. As to this, attention is again called to the authorities relied upon which uniformly hold that payments for a terminable estate constitute capital expenditures deductible over the life of the estate.

II.

The amounts paid to Frank Baird are deductible as annuity payments made in the acquisition of his interest in the property.

All of the factors referred to by respondent (Br. 9-10) in opposition to petitioner's contention that it should also be permitted to deduct the $2,400 paid to Frank Baird in 1936 as expense or loss resulting from the payments of an annuity, are present and apply with equal effect to the determining factors in the case of *Comm.* v. *John C. Moore Corp.*, 42 F. 2d 186 (C. C. A. 2d), upon which petitioner relies (Pet. 11-12) and the same objections were raised by the Commissioner of Internal Revenue in that case, 42 F. 2d, at 187. In that case the taxpayer was not engaged in the commercial writing of annuities but simply acquired property theretofore leased by it agreeing to pay a stipulated sum annually during the life of the owner. Respondent admits (Br. 10) that the language used in the decision in that case is "inconsistent" with the decision of the court below in the instant case but refers to this language as being *"obiter."* Petitioner submits that the language in question is not in fact to be regarded as *obiter*. While the life expectancy of the annuitant in the Moore case had not been reached by the end of the taxable years therein involved, however, in order to determine the amount of the annuity payments allowable for those years as a deduction from income it was necessary to also determine the deductible status of the payments after the life expectancy had been reached and by a determination of the former the latter followed as a matter of course. At the time of the decision in the Moore case the decisions were conflicting, one line of decisions permitted the entire cost of the annuity to be recovered before any tax liability resulted and ignored the life expectancy, while other decisions permitted a portion of the payments to be deducted before the life expectancy was reached.

Respondent cites the case of *Steinbach Kresge Co.* v. *Sturgess*, 33 F. Supp. 897 (D. N. J.). It is not apparent from a careful reading of that decision that the findings of the court in that case would have been any different than in the Moore case had the facts been similar.

As pointed out in the petition for certiorari (Pet. 11-12), the decision of the Circuit Court in the instant case is in every respect in direct conflict with the decision of the court in the Moore Case.

III.

If petitioner is not entitled to deduct the full amount paid to Frank Baird in 1936, it is entitled to deduct as a loss in 1936 that portion ($1,971.44) of the $2,400 that is applicable to the payment for his interest in the building that was demolished in 1923.

In connection with the authorities cited and relied upon by petitioner (Pet. 12-14) in support of its contentions as to this point, respondent asserts (Br. 10-11) that the cases cited are not applicable but does not make any explanation in support thereof except that the case of *Eckert* v. *Burnet*, 283 U. S. 140, involved a loss from the giving of a note and that the decisions in the other cases cited "stemmed" from this case. As pointed out in the petition for certiorari (Pet. 13-14), this Court in a later decision in the case of *Helvering* v. *Price*, 309 U. S. 409, held that the decision in the Eckert case applies and is controlling as to a deduction claimed under a section of the revenue act containing a provision similar to that contained in Section 23 (f) of the Revenue Act of 1936, 49 Stat. 1659, under which the deduction herein is claimed. A reference to the decisions in the cases cited and relied upon by petitioner (Pet. 12) will disclose that they are squarely in point and hold that where the taxpayer is on a cash receipts and disbursements basis that deductions for losses can only be taken in the year or years in which actual payments in cash or its equivalent are made.

There are numerous other decisions holding to the same effect and no decisions have been found and none are cited by respondent holding otherwise. There cannot be the slightest doubt but that the decision of the court below is in direct conflict with the decisions in the cases cited.

Respondent further asserts (Br. 11) "that if any loss was sustained by the taxpayer from demolition of the old bank building it occurred in 1923 and was deductible in that year only," notwithstanding the fact that petitioner filed its return on a cash receipts and disbursements basis (R. 17) and consequently only sustains losses as actual cash payments are made as is uniformly held by all of the authorities. In support of his contention, respondent cites (Br. 11) the cases of *Union Bed & Spring Co.* v. *Comm.*, 39 F. 2d 383 (C. C. A. 7th); *Louis Pitzitz Dry Goods Co.*, 22 B. T. A. 161. Both of these cases involve losses due to voluntary removal or demolition of buildings for which the purchase price had been paid prior to or at the time demolished and it is obvious that the only time the loss in such a case would be allowable would be the year in which demolished irrespective of whether or not the taxpayer was on the accrual or cash receipts and disbursements basis and consequently do not support respondent's contention.

Conclusion.

It is respectfully submitted that the petition for a Writ of Certiorari should be granted.

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